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TAGS: EINV EPET ETRD NU
SUBJECT: NICARAGUA: EXXON REACHES AGREEMENT WITH GOVERNMENT
ON VENEZUELAN OIL, TAXES, AND FUEL STORAGE FACILITIES

REF: A. 2007 MANAGUA 1952
¶B. 2007 MANAGUA 2016
¶C. 2007 MANAGUA 2116
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nd (d)

¶1. (C) Summary. Local ExxonMobil officials report that their negotiations with the Government of Nicaragua over the sale of its storage tanks at the Port of Corinto and the purchase of crude petroleum from Venezuela are drawing to a successful conclusion. On December 14 2007, ExxonMobil and Petronic, Nicaragua's state-owned oil company, signed an agreement providing for Petronic's use of storage tanks at Corinto I for a fee, retroactive to the date that the government seized the tanks. ExxonMobil expects that an agreement to sell ExxonMobil storage facilities at Corinto I to Petronic and an agreement to purchase Venezuelan crude from Petronic, both on commercial terms, along with an exchange of letters settling tax claims against ExxonMobil will be signed sometime during the week of January 21, 2008. The Sandinista side appeared divided and disorganized during the negotiations. In the end, however, Economic Advisor to the President Bayardo Arce was able to gather his side to move the negotiations forward. End Summary.

¶2. (C) ExxonMobil General Manager Joaquim de Magalhaes and former General Manager and now consultant Augustin Fuentes report that negotiations with Petronic over the sale of storage tanks at Corinto I and the purchase of crude petroleum from Venezuela are drawing to a successful conclusion Negotiators have agreed on the terms and all that remains is for ExxonMobil lawyers in Fairfax, Virginia to complete their review of the agreement texts and exchanges of letters. De Magalhaes and Fuentes expect that Fairfax may require small, technical changes.

¶3. (C) This brings to a close a saga that came to a head when the Nicaraguan courts issued a tax lien on ExxonMobil's fuel storage tanks at Corinto I, which was used as a pretext for seizing Corinto I on August 17, 2007 (Ref A). Specifically, the lien was granted for failure to pay or obtain a waiver to pay a value added tax on two shipments of imported oil. The government finally returned these facilities on September 13, 2007 (Ref C). On December 14 2007, ExxonMobil and Petronic, Nicaragua's state-owned oil company, signed an agreement providing for Petronic's use of these facilities for a fee, retroactive to August 17 2007, i.e., the date they were

seized. ExxonMobil expects that an agreement to sell Corinto I to Petronic and an agreement to purchase Venezuelan crude from Petronic, both on commercial terms, along with an exchange of letters settling all outstanding tax claims against ExxonMobil will be signed the week of January 21, ¶2008.

Payment for Services Rendered at Corinto I

¶4. (C) In the "hospitality agreement" signed on December 14 2007, Petronic agreed to pay ExxonMobil for the use of its fuel storage tanks at Corinto I retroactive to August 17 2007, the date of seizure. Petronic has agreed to pay a little over a dollar per barrel of oil stored at Corinto I. The agreement was signed at an impromptu ceremony in front of television cameras and the press before the government closed for the Christmas holidays. Minister of Energy Emilio Rappaccioli used the event to publicize the government's intention to have ExxonMobil buy Venezuelan crude through Venezuela's Bolivarian Alternative for the Americas (ALBA) financing scheme that returns 50% of the purchase price to Nicaragua.

Terms of Sale for Corinto I

¶5. (C) De Magalhaes told Econoff that the terms of the sale to Petronic of the fuel storage tanks at Corinto I are market-based; the final price is below ExxonMobil's asking price but above what Petronic offered. The sales agreement grants ExxonMobil the right to use the largest tank (holding 30,000 gallons) for two years at no charge. (Note: That tank represents more than half of the storage capacity available at Corinto I.) In addition, ExxonMobil retains ownership of its firefighting station to serve its much larger Corinto II fuel storage facility. ExxonMobil will continue to provide water pumping station services to support firefighting at Corinto I for a period of one year, during which Petronic must install its own pumping station. De Magalhaes and Fuentes expect this agreement will be signed the week of January 21, 2008 in Managua.

Purchase of Venezuelan Crude

¶6. (C) De Magalhaes and Fuentes told Econoff that ExxonMobil has agreed to purchase crude oil from Venezuela on commercial terms. ExxonMobil lawyers in Fairfax, Virginia are putting the finishing touches on the agreement now. DeMagalhaes said that the purchase agreement is based on a New York Mercantile Exchange (NYMEX) "gulf coast" price formula. Essentially, ExxonMobil agrees to purchase all crude oil to be refined in Nicaragua from Petronic, which in turn will source the oil through a joint venture with PDVSA, called ALBANISA. Petronic is reportedly a minority partner in ALBANISA with a 45% share. The agreement gives ExxonMobil what it hopes will be a secure supply of Mesa 30, a quality crude that is sometimes hard to find. Should Nicaraguan demand for heavy fuel oil rise, ExxonMobil has the option to source heavier crude from Venezuela to achieve higher yields of fuel oil from its refinery located near Managua.

¶7. (C) Under the terms of the agreement, ExxonMobil will take delivery of the oil in Venezuela and transport it to Nicaragua on its own vessels. This arrangement means that Petronic will sign its oil sales agreement with ExxonMobil Sales and Supply Corporation as opposed to Esso/Nicaragua, the subsidiary that conducts ExxonMobil's business in Nicaragua. Once the oil is on the water, ExxonMobil has the option of shipping it wherever it is needed. ExxonMobil also has the option of sourcing elsewhere should PETRONIC (through ALBANISA and PDVSA) be unable to load a ship within five days of plan. In addition, PETRONIC will be liable for demurrage, thereby shifting some of the risk of doing business with PDVSA to Petronic and the Nicaraguan government. De Magalhaes expects that purchases of crude oil will total $400-500 million dollars in 2008 for 6.5) 7.0 million

barrels of oil. Purchases in 2009 should exceed 7.2 million barrels -- i.e., about 600,000 barrels per month.

Tax Issues

¶8. (C) Central to ExxonMobil achieving an agreement with the government was resolving the onslaught of tax claims filed against the company. At one point, tax claims totaled $70 million dollars, the approximate book value of ExxonMobile assets in Nicaragua. Essentially, these claims will be resolved by a series of side letters to be exchanged when the crude oil sales agreement is signed.

¶9. (C) Most of the tax claims involved the alleged failure of ExxonMobil to pay value added tax at the time of importation, despite the fact that several laws explicitly state that the petroleum industry is not subject to this tax because a separate regime prevails. Indeed, there is no mechanism in place to recover value added tax along the supply chain. Further, ExxonMobil argues that its refinery would not be commercially viable if it had to pay the 14% value added tax on crude oil when its competitors did not pay a tax on refined product. In the end, the government agreed to throw out all claims beyond the 4-year statute of limitations (the lion's share of the claims were between 4 and 15 years old) and put a cap on what remained. A face saving arrangement requires ExxonMobil to pay on what remains, but allows the company to credit "every cordoba" against the selective consumption tax that it owes, thus nullifying the charge.

¶10. (C) Another significant tax claim revolved around which corporate tax rate should apply to ExxonMobil. In 1995, ExxonMobil was granted the right to be taxed at a 25% rate (vice 30%) as an incentive to upgrade and modernize its refinery after the ravages of the 1980s. In 2002, the government reduced the corporate tax rate for all firms to 25%, making the incentive moot. In 2007, the government again raised the overall corporate tax rate to 30%, but assured ExxonMobil in a letter that the 25% rate would continue to apply in its case. The issue was resolved during the negotiation when ExxonMobil accepted to the 30% rate and the government agreed not to assess the 5% difference retroactively.

Sandinista Negotiating Tactics

¶11. (C) The Nicaraguans deployed quite a few Sandinista economic officials in strong-arm tactics against ExxonMobil -- including Economic Advisor to the President Bayardo Arce, Petronic President Francisco "Chico" Lopez, Petronic General Manager Rodolfo Zapata, Minister and Vice Minister of Energy Emilio Rappaccioli and Lorena Lanza, National Electric Company President Ernesto Martinez Tiffer, Director General for Tax Walter Porras and Director General for Customs Eddy Medrano, as well as several lawyers. Regulator David Castillo and members of the business federation COSPEP also participated in some meetings as facilitators.

¶12. (C) Fuentes reports that as a group, the Sandinista side holds a very simplistic view of business, does not understand the oil industry, and lacks understanding of the importance of reliability and safety. De Magalhaes comments that the Sandinista side does not seem to realize that its mafia-like behavior, threats, and propaganda are not necessary to negotiate commercial deals. Both felt that the Sandinista side lacks confidence in its ability to negotiate and always believes that companies are lying to them. The Sandinistas always state publicly that the other side is demanding too much and giving too little, while the exact opposite is true.

¶13. (C) Politics and party rank clearly play a role for the Sandinista side. De Magalhaes and Fuentes report that the presence of party apparatchik Chico Lopez changed the behavior and attitude of others. With Lopez present, Rappaccioli would talk about the revolution and his experience working with Ortega in the 1980's. Though as

Petronic President, Lopez is supposed to report to Rappaccioli, in practice the opposite seems to be true. This reversal of authority caused de Magalhaes and Fuentes to view Rappaccioli as a second tier player who always waits for the politicos to come to terms on an issue before speaking. When Rappaccioli is free of his political yoke, however, he is a more pragmatic player.

¶14. (C) Bayardo Arce played a calming role, although the most thuggish tactics occurring immediately before he arrived on the scene were perhaps by his design. De Magalhaes and Fuentes found Arce to understand business and willing to take a more pragmatic and forward looking approach to resolving issues. Lopez, on the other hand, often shows up with a roll of papers to support his arguments about what he claims people said two months ago. Both de Magalhaes and Fuentes commented that Lopez and Arce seem to be rivals. Each would tell ExxonMobil to go the other first to get a chop, and then come back to them. Both Arce and Lopez seem to derive most of their power from their relationship with President Ortega.

¶15. (C) De Magalhaes and Fuentes found Director General for Tax Walter Porras and Director General for Customs Eddy Medrano more ideologically oriented. However, Porras is a more sophisticated and respectful person. Nevertheless, on one occasion Porras entered into a shouting match with ExxonMobil lawyers. Director General for Customs Eddy Medrano is not very well educated and shouts a lot. An engineer by training, Petronic General Manager Rodolfo Zapata is the easiest with which to work, but stays quiet when important issues are discussed. Fuentes, who prides himself in getting along with just about anybody, complained that he simply could not tolerate ENEL President Ernesto Martinez Tiffer, who he found to have "a level of knowledge that was below zero."
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